

IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1991

**QUILL CORPORATION,**

*Petitioner,*

**STATE OF NORTH DAKOTA,  
by and through its Tax Commissioner,  
HEIDI HEITKAMP,**

*Respondent.*

**On Writ of Certiorari to the  
Supreme Court of the State of North Dakota**

**REPLY BRIEF**

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**REPLY BRIEF**

I.

**COMPLETE AUTO DOES NOT OVERRULE  
*BELLAS HESS***

North Dakota directly challenges the continuing validity of this Court's decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), and contends that *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), overruled *Bellas Hess* 15 years ago.<sup>1</sup> Resp. Br. at 10, 15, 17. To the contrary, *Complete Auto* reconfirmed the *Bellas Hess* requirement that an out-of-state business must have "substantial nexus" with a state

<sup>1</sup> North Dakota acknowledges that the recent amendments to the North Dakota Use Tax Act would be constitutionally deficient if tested in 1967 under the *Bellas Hess* rationale. Brief for Respondent (hereinafter "Resp. Br.") at 10, 15. See also Brief for Petitioner (hereinafter "Pet. Br.") at 47 n.45 (the North Dakota legislature also recognized that the 1987 amendments to the North Dakota Use Tax Act when enacted conflicted with *Bellas Hess*).

before a tax obligation may be imposed on that business.<sup>2</sup>

North Dakota asserts that *Bellas Hess* is grounded on an interpretation of the commerce clause that prohibits all state taxation of businesses engaged in interstate commerce.<sup>3</sup> Resp. Br. at 10, 16-17. *Bellas Hess* stated:

[i]f the power of Illinois to impose use tax burdens upon [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote . . .

The very purpose of the Commerce Clause was to ensure a *national economy free from such unjustifiable local entanglements*. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

*Bellas Hess*, 386 U.S. at 759-60 (emphasis added).

North Dakota argues that this analysis embodies the free trade rule articulated in *Freeman v. Hewit*, 329 U.S. 249 (1946) and *Spector Motor Service Inc. v. O'Connor*, 340 U.S. 602 (1951). Resp.

<sup>2</sup> North Dakota contends that this Court has never limited tax nexus to localized, intrastate activities physically conducted by the out-of-state vendor within the taxing state. Resp. Br. at 26. North Dakota's contention belies this Court's reasoning in cases preceding and succeeding *Bellas Hess* (Pet. Br. at 15-19, 27-33) which held that out-of-state mail order vendors that did not conduct a localized, intrastate business were not obligated to collect the state's use tax. See, e.g., *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 365 (1941) where the Court stated:

[T]hose [mail order businesses] are not doing business in the state as foreign corporations. Hence, unlike [Sears] they are not receiving benefits from Iowa for which it has the power to exact a price.

*Id.* (Bracketed material added.)

See also *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 555 (1977):

[N]ot every out-of-state seller may constitutionally be made liable for payment of the use tax on merchandise sold to purchasers in the [taxing] State.

*Id.* (Bracketed material added.)

<sup>3</sup> North Dakota restates the issue in *Bellas Hess* to be whether the use tax in question was a tax on the "privilege of engaging in interstate commerce." Resp. Br. at 16-17. A use tax is not a "privilege tax." *General Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 335, 338 (1944). Quill does not contend in this case that North Dakota may not tax North Dakotans who purchase mail order goods; it only contends that North Dakota lacks jurisdiction to impose that tax obligation on Quill.

Br. at 16-17. In fact, the quoted language restates the universally accepted meaning of the commerce clause. It is the same analysis found in post-*Bellas Hess* and post-*Complete Auto* cases such as *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328-29 (1977) and *Dennis v. Higgins*, 111 S.Ct. 865, 870-71 (1991).

The antecedents of *Bellas Hess* are not *Freeman* and *Spector* but the line of cases applying a commerce clause analysis to state use taxes. They are *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939); *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373 (1941); *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954); and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). The Court in *Bellas Hess* quoted from *Freeman* solely for the proposition that "state taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." 386 U.S. at 756. The opinion goes on to say that the same principles have been held applicable in determining the power of a state to impose the burden of collecting use taxes upon interstate sales. "Here, too," said the Court, "the Constitution requires 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax'. *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345; *Scripto, Inc. v. Carson*, 362 U.S. 207, 210-211." *Bellas Hess*, 386 U.S. at 756-57.

In *Bellas Hess* the Court described cases involving a variety of circumstances in which it had upheld the power of a state to impose liability on an out-of-state seller to collect a local use tax on an interstate sale. It then declared: "[T]he Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail." 386 U.S. at 758. Nowhere in the opinion is the tax or the collection liability characterized as a tax on the "privilege" of engaging in interstate commerce, and, therefore, unconstitutional under the holdings of *Spector* and *Freeman*.

North Dakota's historical revisionism also ignores the fact that by 1967 interstate commerce was subjected to state and local property taxes, use taxes, capital stock taxes, and direct net income taxes. In fact, the only state tax not imposed on interstate commerce was, under the *Spector* rule, one for the "privilege" of engaging in interstate commerce — a privilege the court believed was not one a state had the power to deny or tax.<sup>4</sup> But even that "draftsmanship" rule of *Spector* had been narrowed to one of phraseology by 1959 — long before *Bellas Hess* was decided. See *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Complete Auto*, 450 U.S. at 284-85, 287 n.14.

In *Complete Auto*, the sole issue was the constitutionality of a "privilege tax", 450 U.S. at 278, imposed on the gross income of *Complete Auto* from providing transportation services to automobile dealers located in Mississippi.<sup>5</sup> 430 U.S. at 275-76, 287. *Complete Auto* argued that the services it provided in Mississippi were but one link in the chain of interstate commerce that was previously placed off-limits to state "privilege" taxes in *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951). This

Court quickly recognized that *Spector* did not control the issue in *Complete Auto*.<sup>6</sup>

*Complete Auto* is entirely consistent with the Court's decision in *Bellas Hess*. In order to sustain a state tax under commerce clause challenge, the first prong of the *Complete Auto* test requires a finding of an "activity with a substantial nexus with the taxing State" and the fourth prong requires that the tax obligation be "fairly related to the services provided by the State" to the taxpayer.<sup>7</sup> *Complete Auto*, 430 U.S. at 279. These tests are not only consistent with *Bellas Hess*, they had been applied by the

<sup>6</sup> First, the *Spector* rule refused to look to the "practical effect of the tax" in question. 430 U.S. at 278. Under the *Spector* rule, a state tax on interstate business labeled as a "privilege" tax would unequivocally be stricken; whereas a tax of identical economic consequence called by a different name might survive a commerce clause attack. Compare *Railway Express Agency v. Virginia*, 347 U.S. 359 (1954) where the Court struck down an "annual license tax" levied on gross receipts for the privilege of doing business in the State of Virginia with *Railway Express Agency v. Virginia*, 358 U.S. 434 (1959) where the same tax was upheld under a new name. *Complete Auto*, 430 U.S. at 284. Second, the *Spector* rule could insulate interstate business from tax, even though the taxpayer physically carried on local business activities within the taxing jurisdiction. Third, the *Spector* rule had in effect been abandoned by the Court in 1959, approximately eighteen years prior to *Complete Auto* by its decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959). See *Complete Auto*, 430 U.S. at 285, 287, n.14. The Court in *Northwestern States Portland Cement* applied the same rationale for taxing income derived from interstate business activities that it applied in *Complete Auto*:

We conclude that net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same.

*Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. at 452 (emphasis added). Cf. *Complete Auto*, 430 U.S. at 279 (four prong test).

<sup>7</sup> At page 20, Resp. Br., North Dakota completely misstates the first and fourth prongs of the *Complete Auto* test by asserting that:

The first and fourth prongs of the *Complete Auto* test are "a minimal connection between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise."

*Compare* Resp. Br. at 20-21 with Reply Br. text accompanying this n.7 and *Complete Auto*, 430 U.S. at 279.

<sup>4</sup> See *Developments in the Law — Federal Limitations on State Taxation of Interstate Business*, 75 Harv. L.Rev. 953 (March 1962).

<sup>5</sup> *Complete Auto* operated substantial property located in Mississippi (office, storage yard, maintenance facilities and trucks) and its employees performed a full array of transportation services in the state. Brief of the Appellee at 5-6, 12; Appendix at 4-6, 81-88, *Complete Auto Transit* (O.T. 1976, No. 76-29).

Court in sales/use tax cases decided before and after *Bellas Hess*.<sup>8</sup>

In each of the cases where this Court found nexus sufficient to sustain the tax on the interstate business in question, the taxpayer conducted localized business activities which included a substantial physical presence with that taxing jurisdiction. Contrary to North Dakota's assertion, this Court has never intimated in any of its decisions that *Complete Auto* eliminated the constitutional requirement (determinative in *Bellas Hess*) that there be a substantial localized activity conducted within the state by the mail order vendor before that state has jurisdiction to impose a tax on the out-of-state business.<sup>9</sup> Additionally, any

<sup>8</sup> See Pet. Br. at 15-19 and 27-34. The Court also applied these standards in 1959 when it upheld state taxation of income derived from interstate businesses that maintained offices and employees within the taxing jurisdictions. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 454 (1959) (maintained a large office, salesmen, employees, and automobiles in Minnesota); *Williams v. Stockham Valves and Fittings*, 358 U.S. 450, 455-56 (1959) (maintained an office, equipment and employees in Georgia); *Brown Forman Distilleries v. Collector of Revenue*, 101 So.2d 70 (1958), cert. denied, 359 U.S. 28 (1959) (salesmen/ "missionary men" in Louisiana); *International Shoe v. Fontenot*, 107 So.2d 640 (1958), cert. denied, 359 U.S. 28 (1959) (fifteen salesmen in Louisiana).

<sup>9</sup> See *Goldberg v. Sweet*, 488 U.S. 252 (1989) (where the taxing state had substantial nexus over the taxpayers, the tax collecting agent and the telecommunications reached by the tax), *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) (taxpayer owned and operated 13 department stores that employed about 5,000 workers in the taxing state), *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (taxpayer conducted substantial mining activities in the state) and *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977) (taxpayer maintained offices and employees in the state) discussed in Pet. Br. at 15-16 n.6, 27-33.

For cases where taxpayers' activities did not create a substantial nexus with the taxing state, see *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954); *Bloomingdale's By Mail, Ltd. v. Commonwealth of Pennsylvania*, 567 A.2d 773 (Pa. Commw. 1989), aff'd per curiam, 591 A.2d 1047 (Pa. 1991), cert. applied for sub nom. *Penn. v. Bloomingdale's By Mail, Ltd.*, No. 91-383; *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (1991), cert. denied, 111 S.Ct. 2839 (1991); *Cally Curtis Co. v. Groppo*, 572 A.2d 302 (Conn.), cert. denied, 111 S.Ct. 77 (1990); *L.L. Bean, Inc. v. Commonwealth of Pennsylvania*, 516 A.2d 820 (Pa. Commw. 1986); *Direct Marketing Ass'n v. Bennett*, No. Civ. S-88-1067 (E.D. Cal. July 12, 1991) (1991 U.S. Dist. LEXIS 10736); *Land's End, Inc. v. California Bd. of Equalization*, No. 620135 (San Diego Superior Court, Cal. 1991), appeal docketed, No. DO14839 (Cal. App. 4th, July 15, 1991); and *Sturbridge Yankee Workshop Inc. v. California Bd. of Equalization*, No. 512584 (Sacramento Superior Court, Cal. 1991), appeal docketed, No. CO11169 (Cal. App. 3d, May 30, 1991).

tax imposed has to be fairly related to the services provided by the state to the taxpayer (fourth prong of *Complete Auto*). Compare *Bellas Hess*, 386 U.S. 756-58, 760 with *Complete Auto*, 430 U.S. at 279. North Dakota's contention that the *Bellas Hess* standard has been undermined and overruled by *Complete Auto* defies scrutiny of the applicable authorities.<sup>10</sup>

## II.

### IN PERSONAM JURISDICTION IS NOT A SUBSTITUTE FOR "SUBSTANTIAL NEXUS"

North Dakota urges that the nexus standard in tax and personal jurisdiction cases is or should be the same. Resp. Br. at 23-25.<sup>11</sup> This attempt to conflate the "substantial nexus" standard used in tax cases and the "minimum contacts" standard used in personal jurisdiction cases ignores the fundamentally different constitutional concerns which they reflect.<sup>12</sup> In *Burger*

<sup>10</sup> North Dakota's argument also misses the mark because nexus is not at issue in the very cases it cites; whereas in *Bellas Hess* nexus is the only issue. Just as nexus for tax purposes was the issue in *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941), *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954), and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); it was not an issue in *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985) which cites *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), or in *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980) which cites *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940) - cases which North Dakota mistakenly argues support its contention that *Bellas Hess* has been rejected by this Court. In each of the cases relied upon by North Dakota, the taxpayer had employees or property in the taxing state. Although tax nexus was not an issue in *Mobil*, the Court cites *Bellas Hess* in support of the principle that before a state may tax income generated in interstate commerce, there must be some "intrastate values of the enterprise" carried on within the state. 445 U.S. at 436-37. *Mobil* carried on substantial wholesaling and marketing activities in Vermont, reporting an annual Vermont payroll in excess of \$230,000 and Vermont property values ranging from \$3.9 million to \$8.2 million for the years in question. 445 U.S. at 428-29.

<sup>11</sup> North Dakota admits that *Complete Auto*'s "substantial nexus" test incorporates both commerce clause and due process clause concerns, Resp. Br. at 20-21, but it then avoids any further discussion of the role of the commerce clause.

<sup>12</sup> North Dakota's reliance on *International Shoe Co. v. Washington*, 326 U.S. 310 (1945) to suggest that the "minimum contacts" analysis for personal jurisdiction should control this case also ignores the role of the commerce clause. While *International Shoe* involved taxes, the unemployment tax in question was immune from commerce clause challenge. Congress had given the states specific authority to impose those taxes on compensation paid to employees performing services within the state. 326 U.S. at 315, 321. Thus, that decision does not address commerce clause concerns.

*King Corp. v. Rudzewicz* 471 U.S. 462 (1985), the Court explains this difference.

In *Burger King*, the Court considered whether a franchisee could fairly be required to defend a claim by its franchisor in the State of Florida. The Court pointed out that the requirements of the due process clause in personal jurisdiction cases are "a function of the individual liberty interest preserved by the Due Process Clause". 471 U.S. at 472, n.13. However, due process clause requirements do not address "federalism concerns". *Id.* See also *Insurance Company of Ireland, Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702-703 n.10 (1982). Federalism concerns are, of course, at the heart of commerce clause requirements which limit state taxation of interstate businesses.

It was precisely "federalism" concerns which the Court highlighted in *Bellas Hess*, that to permit Illinois and other states to tax *Bellas Hess* would entangle the company in:

a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of local government."

The very purpose of the Commerce Clause was to insure a national economy free from such unjustifiable local entanglements.

*Bellas Hess*, 386 U.S. at 760.

The adoption of a "minimum contacts" test in personal jurisdiction cases and a "substantial nexus" test in commerce clause cases reflects more than a mere difference in terminology.<sup>13</sup> *In personam* jurisdiction balances the interests of claimants and out-of-state defendants with respect to the forum in which their controversy will be determined. It generally does not affect substantive rights or obligations. The appropriateness of the limitations placed on such jurisdiction takes into account the

<sup>13</sup> In *Bellas Hess*, the Court rejected Illinois' argument that the due process standards for personal jurisdiction and tax jurisdiction were similar and refused to apply *McGee v. International Life Insurance Co.*, 355 U.S. 220 (1957) — which involved a classic mail order insurance operation where the company had no physical contacts with the state except solicitations by mail — as the standard to determine tax nexus. Brief of Appellee at 32-34, *Bellas Hess* (O.T. 1966, No. 241). In *McGee*, the Court upheld the state court's *in personam* jurisdiction over the insurance company, ruling that physical presence was not required by the due process clause for adjudicatory jurisdiction.

North Dakota's contention that adjudicatory and tax jurisdiction standards are similar falters considering that neither the majority nor dissenting opinions applied *McGee* to determine the tax obligations of *Bellas Hess*.

extent of the burden on defendants in defending a lawsuit at a location distant from residence or principal place of business, entailing the inconvenience of transporting documents and witnesses over a considerable distance. In balancing those burdens with the burdens imposed on claimants bringing suit in a foreign jurisdiction, the Court looks to whether "the maintenance of the suit" would "offend traditional notions of fair play and substantial justice." *International Shoe*, 326 U.S. at 316.

The commerce clause requires a different analysis of the tax burden from that which North Dakota, its sister states and local taxing bodies would place on out-of-state vendors having no contacts with customers in the taxing state other than by electronic communication, U.S. mail or common carrier. Tax jurisdiction entails burdens of complying with the tax laws of the state.<sup>14</sup> A multitude of affirmative obligations and liabilities

<sup>14</sup> The tax burdens imposed on the out-of-state business as part of its obligation to collect a state's use tax, include:

- a. The requirement to register under the state's taxing acts and be subject to all tax requirements imposed on "retailers" conducting an in-state business (N.D.C.C. §57-40.2-07(1));
- b. The obligation to remit all taxes due even if the customer refuses to pay, requiring the business to either pay the tax out of its own funds or refuse the sale (N.D.C.C. § 57-40.2-07(3));
- c. The posting of a substantial bond with the state (N.D.C.C. 57-40.2-07(8));
- d. Processing and filing claims for refund of overpaid taxes on behalf of customers erroneously paying tax. (N.D.C.C. §57-40.2-17);
- e. Keeping abreast of all changes in the tax law including rate, filing dates, and applicable exemptions involving approximately 6,500 jurisdictions (Pet. Br. at 39);
- f. Bearing the substantial burden of informing customers every time the state changes its tax laws, often leaving the business unable to change catalogs and advertising materials that have been printed or previously mailed;
- g. Being subject to penalties and interest attributable to customers' late or underpayment of tax (N.D.C.C. § 57-40.2-15(1));
- h. Corporate officer and employee liability for taxes, interest and penalties on amounts never remitted by the customer (N.D.C.C. § 57-40.2-15.1);
- i. Being subject to audit by the state (N.D.C.C. § 57-40.2-09);
- j. Being liable for substantial civil penalties for violations of the state use tax provisions (N.D.C.C. § 57-40.2-10 (revocation of right to make sales in the state); § 57-40.2-16 (lien on property); § 57-40.2-15(4) (criminal penalties)).

See Pet. App. A47-A54.

to the state are created.<sup>15</sup> These greater burdens require a higher level of contact, "a substantial nexus," 430 U.S. at 279, to justify the state's imposition of the burden of tax liability and compliance obligations. North Dakota's blithe dismissal of these burdens, Resp. Br. at 25, ignores the constitutional distinction between *International Shoe* and *Bellas Hess*.

Quill does not have the substantial nexus with North Dakota necessary to justify the obligations which the State wishes to impose. In the absence of these contacts, the commerce clause prohibits North Dakota from imposing tax obligations on Quill.

### III.

#### **ADOPTION OF NORTH DAKOTA'S *IN PERSONAM* JURISDICTION STANDARD EFFECTIVELY NEGATES ESSENTIAL COMMERCE CLAUSE RESTRICTIONS**

North Dakota's substitution of the *in personam* standard for the *Bellas Hess/Complete Auto* standards, Resp. Br. at 20-23, is a sharp departure from established law which has guided businesses, states and the courts for fifty years.<sup>16</sup> North Dakota's

<sup>15</sup> A description of the cumulative effect of the tax burdens involved is set out in Amici Brief of New Hampshire, et al. at 18-22 and Amici Brief of American Council for the Blind, et al. at 11. These burdens would be especially severe for small mail order businesses. Amicus Brief of Coalition for Small Direct Marketers at 10-11, 17-20; Amici Brief of Carrot Top Industries, Inc., et al. at 9-11; Amicus Brief of Direct Marketing Association at 16-23; and Amici Brief of American Council for the Blind, et al. at 8-17.

The impact of the North Dakota Supreme Court's ruling extends beyond mail order vendors and impacts publishers, financial organizations and service businesses generally. Amici Brief of Magazine Publishers of America, Inc., et al. at 10-12; Amicus Brief of American Bankers Association, et al. at 8; and Amicus Brief of Tax Executives Institute, Inc. at 18-22.

<sup>16</sup> In the last two terms, this Court has refused to grant certiorari in two cases raising the same issue as *Quill*. *Cally Curtis v. Groppe*, 572 A.2d 302 (Conn. 1990), cert. denied, 111 S.Ct. 77 (1990); *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991), cert. denied, 111 S.Ct. 2839 (1991). Prior to that, this Court has cited with approval *Bellas Hess* on at least six occasions, most recently in 1989; lower state and federal courts have referred to *Bellas Hess* in approximately 70 cases, most recently in 1991. See Pet. Br. at 27-33, App. 4 to Pet. Br. at 26a-29a, and Pet. App. A76-A81.

position could lead to an abyss of uncertainty in the law that would in all likelihood generate unnecessary litigation.<sup>17</sup>

North Dakota's administrative rule of "three mailings" extends North Dakota's tax jurisdiction to Quill and others; in other states, one sale satisfies the same standard adopted by the North Dakota statute.<sup>18</sup> The test urged by North Dakota, Resp. Br. at 20-23 extends a state's taxing jurisdiction to interstate businesses that have no presence in the state, under the pretext that the interstate business benefits from the services the state is providing to its own residents. Resp. Br. at 33. Under North Dakota's test *no* service of any kind would ever have to be provided to the interstate business. North Dakota makes no effort to define the true limits of its proposed test and, in fact, no standard is created. Whether three solicitations or a single sale, abandonment of the *Bellas Hess* standard will eliminate essential commerce clause protection.<sup>19</sup>

<sup>17</sup> North Dakota's approach is also inconsistent with *National Geographic*, 430 U.S. 551, where this Court did not adopt California's "slightest presence" test, stating:

[N]ot every out-of-state seller may constitutionally be made liable for payment of the use tax on merchandise sold to purchasers in the [taxing] state.

*National Geographic*, 430 U.S. at 555, discussed in Pet. Br. at 28.

<sup>18</sup> See, for example, Brief Amicus Curiae State of New Jersey at 1 and Brief Amicus Curiae State of New Mexico at 4-5, where one sale into those states is sufficient to impose tax liabilities on the out-of-state vendor.

<sup>19</sup> North Dakota urges reversal of *Bellas Hess* in order to restore a competitive advantage to North Dakota retailers who are obligated to pay North Dakota sales tax as a result of their intrastate activities. Resp. Br. at 6-7, 18; R. 211-27. There is a dearth of evidence to support North Dakota's suggestion, Resp. Br. at 6-7, that consumers purchase merchandise by mail to avoid a state's sales/use tax. See *Collection of State Sales and Use Taxes by Out-of-State Vendors: Hearing on S.639 and S.1099 Before the Subcomm. on Taxation and Debt Management of the Comm. on Finance*, 100th Cong. 2nd Sess. (1987) at 37-38 (colloquy between Sen. Mitchell and Messrs. Baldwin, of the National Ass'n of Tax Administrators, and Hanson, of the Multistate Tax Commission, over the failure of states and retailers to provide any evidence to Congress to substantiate their claims that imposition of sales/use taxes affect consumer purchasing decisions). In fact, the State of North Dakota, which is exempt from state sales/use taxes, purchases products from Quill, presumably "to get the best deal possible." Patrick Spaeth, *State Buys Products From Firm It Is Suing*, Bismarck Tribune, December 24, 1991, at 1A, 12A.

If the historical standard in tax jurisdiction cases is to be abandoned, what will take its place? North Dakota argues that the test should *not* be simply mechanical, or quantitative, or formulary. Resp. Br. at 27. North Dakota would apparently prefer to apply a facts and circumstances test to establish the tax liability of out-of-state vendors. Resp. Br. at 28. What are those minimum contacts that will establish that tax liability? The closest that North Dakota comes to providing an answer or defining a standard is to quote from the language in *Burger King Corp.*, 471 U.S. at 476 (1985), which upholds personal jurisdiction if "a commercial actor's efforts are 'purposefully directed' toward residents of another State." Resp. Br. at 25-26. This is the same standard advanced by Illinois on oral argument in *Bellas Hess*:

Mr. MacCarthy: . . . I think there should be some kind of a rule they [businessmen] should understand. And the rule that I would suggest be distilled from the cases of this Court is a rule which businessmen should well understand, and that is simply where a business is successfully in a state from a business point of view that that should be equated with presence from a legal point of view.

Transcript of Oral Argument at 33, *Bellas Hess*, 386 U.S. 753 (O.T. 1966 No. 241), reproduced in Pet. Br., App. 1 at 6a.

North Dakota advances to this Court the same theory rejected in *Bellas Hess*. North Dakota's proposal seeks to measure state taxing jurisdiction not against current tax jurisprudence but rather against each state's subjective assessment of what is "fair and just."<sup>20</sup> North Dakota's proposed standard amounts to a "facts and circumstances" approach that would guarantee uncertainty over the issue of a state's authority to tax out-of-state businesses that derive an alleged and amorphous "economic benefit" but do not conduct business activities in the state in the traditional sense. North Dakota makes no effort to explain the limits of its proposed new test.

The jurisdictional tests advanced by North Dakota, Resp. Br. at 23-28, will in all likelihood lead to unnecessary litigation to resolve the inevitable confusion that would be created in the

<sup>20</sup> Will advertising in a national magazine create tax jurisdiction in every state in which the magazine is circulated? See *Keeton v. Hustler Magazine, Inc.* 465 U.S. 770 (1984) and *Calder v. Jones*, 465 U.S. 783 (1984), where an author (in *Calder*) and a publisher (in *Hustler*) of articles appearing in national magazines were subject to libel actions in states where the magazines were circulated.

business community, state tax administration and the courts if a reliable and predictable standard is replaced with a subjective "totality of the circumstances" test.<sup>21</sup>

#### IV.

#### NORTH DAKOTA DOES NOT PROVIDE SERVICES TO QUILL

At pages 31-35 of its brief, North Dakota attempts to respond to the concerns of the trial judge who explicitly asked: What services were provided by North Dakota to Quill?<sup>22</sup>

The litany of services that North Dakota recites to this Court covers the gamut of all services provided by North Dakota to its residents. Resp. Br. at 33-34. North Dakota argues that Quill receives the benefit of all these services because it is doing business in North Dakota. This argument assumes the answer. The trial court did not find any fact which would establish that Quill does business in North Dakota. In fact, it found to the contrary. Pet. App. A40. North Dakota, ignoring the traditional tests for "doing business," comes to its conclusion by relying upon the reasoning contained in the dissent in *Bellas Hess*. 386 U.S. at 762-63.

Stripped to the bone, North Dakota's argument is quite simply that because Quill solicits North Dakota residents on a regular basis, it is "carrying on a business" in North Dakota. Having so argued, North Dakota can point to nothing in the record to distinguish Quill from *Bellas Hess*. Pet. Br. at 17-34.

<sup>21</sup> Cf. *Burnham v. Superior Court of California*, 110 S.Ct. 2105, 2117 (1990) (where Justice Scalia eschewed the "totality of the circumstances" test because it did not establish a rule of law but, instead, fostered uncertainty and litigation).

<sup>22</sup> The trial judge stated:

Rather than dwell on the intricacies of title passing as the State has done in this case, they should have been presenting facts to the Court showing that the State of North Dakota spends funds for the protection and benefit of the mail order business. By doing so, they could show that taxation was not only for the benefit of local residents, but for the benefit of the mail order houses. . . . The focus must be on the beneficiary of the taxes as opposed to the consequences. Until this can be established, it would appear that the tax dollars spent protects the local resident and does not benefit the out of state mail order business in any significant manner.

Pet. App. A41, *North Dakota v. Quill*, (Dist. Ct. Mem. Op.).

In reviewing the record herein, the trial court found that "In *Hess*, the facts are very similar to those found in this case". Pet. App. A40. It is not disputed that the services allegedly provided by North Dakota to Quill were similar to the services allegedly provided by Illinois to Bellas Hess. It is not disputed that Illinois' activities in *Bellas Hess* resulted in the maintenance of a market among Illinois residents comparable to that in North Dakota. North Dakota's argument is reduced to the proposition that since a state confers benefits upon persons within its borders, it indirectly confers benefits upon anyone outside of those borders who solicits those residents, and that those "indirect" benefits are sufficient to sustain an extraterritorial tax obligation on the out-of-state vendor. This is precisely the argument considered and rejected in *Bellas Hess*. 386 U.S. at 760 (Fortas, J., dissenting). In *Bellas Hess*, it was pointed out to this Court that acceptance of Illinois' "economic benefit" argument would have the following results:

Upon this theory Massachusetts could tax Florida hotels because the prosperity it bestows upon Massachusetts residents enables them to visit those resorts. Minnesota could tax Michigan factories because her farmers are a market for Michigan tractors and cars. Idaho could reach out and tax the seller of gasoline in Utah where the property was to be brought into Idaho following the purchase. It was to prevent just such mutual aggressions and economic retaliation that the States entered into the federal union.

Reply Brief for Appellant at 8-9, *Bellas Hess*, 386 U.S. 753 (O.T. 1966, No. 241).

The lower court's question — What services has North Dakota performed for Quill? — remains unanswered by North Dakota. Based upon the record herein the answer is none!

#### V.

#### **NORTH DAKOTA HAS MISSTATED MATERIAL FACTS**

North Dakota misstates the record when it repeatedly alleges that "unlike Bellas Hess, Quill owned property [QSL diskettes] physically present in [North Dakota]." Resp. Br. at 15; *see also* Resp. Br. at 13, 30, 45, 46. The Record does not support the State's contention.

The gravamen of the North Dakota complaint against Quill under its "economic benefits" theory is that Quill sells merchandise "using state-of-the-art marketing techniques, including a software program" that permits Quill customers to order merchandise by telephone and to communicate with other Quill customers about Quill products. Respondent's Brief in Opposition to the Petition for Writ of Certiorari at 2; *see North Dakota v. Quill*, Pet. App. A29; Resp. Br. at 5, 33, 45-46.

QSL (also known as Quill Service Link) is a software program<sup>23</sup> with a retail value of \$15 each that Quill sells or occasionally gives at no charge to customers who purchase computers. (R. 130, 231, 243 — separately bound; J.A. 47). Quill sold or gave QSL to six customers in North Dakota (R. 123), only one of whom has ever used it to order merchandise from Quill (R. 123).

The Record does not support North Dakota's contention that Quill "retains title" to QSL while the diskettes are in the customer's possession (Resp. Br. at 5, 45) or that Quill retains any physical control over QSL or the diskette after sale or gift of the diskette to the customer. (R. 231; J.A. 31, 47.) The intangible right that Quill has under the software agreement to terminate access for inappropriate use of the program is distinct from the customer's ownership and use of QSL.<sup>24</sup> That intangible right is indistinguishable from the protections offered under trademark, trade name, copyright and patent laws. Bellas Hess clearly retained comparable intangible rights in its catalogs and advertising flyers distributed in Illinois and had an even larger intangible interest in accounts receivable owed by Illinois

<sup>23</sup> QSL allows the customer to keep a diary of activities, keep track of its own inventory (not Quill's inventory as alleged by Respondent, Resp. Br. at 5, 30, 46), order merchandise from Quill, and place messages on the "electronic bulletin board" maintained on a Quill micro-computer located in Illinois to which other QSL customers have telephone access. (R. 247-77.) QSL users are prohibited from unauthorized copying, commercial advertising or publishing of any profane, abusive or offensive language on the "electronic bulletin board". (R. 273, 280.) A QSL user who would violate the rules established for use of the "electronic bulletin board" loses its access privilege, i.e., its access code is deleted from Quill's computer memory. (R. 231, 273, 280; J.A. 47.)

<sup>24</sup> The QSL software agreement is reproduced in the Appendix to the Reply Brief and is included in the Record at R. 246 and 249.

customers.<sup>25</sup> Any right that Quill has under the software agreement has no connection with North Dakota; the agreement specifically provides that any dispute between Quill and the customer will be governed by the laws and courts of Illinois. (App. to Reply Br.; R. 246.)

North Dakota erroneously states that Bellas Hess did not conduct its business with Illinois residents by telephone. Resp. Br. at 46. The record in *Bellas Hess* clearly establishes that Bellas Hess sold merchandise by telephone from its facilities in Missouri.<sup>26</sup>

North Dakota contends that Quill has a meaningful "presence" in North Dakota by communicating with customers by telephone but the Record establishes that Quill does not have any telephone listing, toll-free telephone line, "800" number or WATS line in North Dakota (R. 88; J.A. 32) and that Quill does not solicit by means of any communication system owned by Quill and located in North Dakota (R. 100, 101-02; J.A. 31-32). North Dakota's reference to "Quill's computer modem/telephone line connection with its North Dakota customers" (Resp. Br. 45; *see also* Resp. Br. at 13 and 46), is to property and equipment that Quill owns and operates only in Illinois. (R. 270, 273; J.A. 47.) Quill does not own, control or have an interest in any computer modem located in North Dakota. (R. 232; J.A. 47.)

Quill conducts no business in North Dakota except by United States mail, telephone and common carrier. (R. 87-90, 231-32; J.A. 29-33 and 44-48; Pet. App. A39, *North Dakota v. Quill* (Dist. Ct.

<sup>25</sup> North Dakota's reliance (Resp. Br. 46) on *In re Heftel Broadcasting Honolulu, Inc.*, 554 P.2d 242 (Hawaii 1976), *cert. denied*, 429 U.S. 1073 (1977) is misplaced. *Heftel* held that CBS was subject to the Hawaii gross income tax on income it earned by leasing 104 films of the TV series *Wild Wild West* to a local TV station. CBS retained ownership and control over all films while they were used by the TV station in Hawaii. Under CBS' agreement the station was obligated to preserve and safeguard each film and return it to CBS in the same condition within 24 hours after broadcast. In the event of damage to any film, the TV station was obligated to reimburse CBS for the costs of making a new print. The films constituted substantial tangible property located in Hawaii and thereby subjected CBS to tax in that state. 554 P.2d at 245-48.

<sup>26</sup> Record on Appeal, National Bellas Hess 1967 Catalog, Spring and Summer Ed. (O.T. 1966, No. 241); Affidavit of Thomas Curry (former Vice President of Marketing with Bellas Hess) at J.A. 49, *Quill* Record on Appeal at R. 234-35, and National Bellas Hess Catalog, attached as Ex. I-2 (R. 235 — separately bound).

Mem. Op.). The Record does not support North Dakota's factual allegations to the contrary.

## VI.

### STARE DECISIS IS PARTICULARLY APPosite

North Dakota asks this Court to overrule a construction of the commerce clause that is based on fifty years of case law. Resp. Br. at 17. North Dakota totally ignores *stare decisis* considerations and dismisses the legitimate concern of "retroactive application" in a footnote, Resp. Br. at 35-36 n.9, with respect to that reversal. Resp. Br. at 17, 47.

This Court has repeatedly recognized that the doctrine of *stare decisis* is of fundamental importance to the rule of law, promoting stability, predictability and respect for judicial authority. *Hilton v. South Carolina Public R. Comm'n*, 60 U.S.L.W. 4056, 4057 (U.S. Dec. 16, 1991) (No. 90-848); *Vasquez v. Hillery*, 474 U.S. 254, 265-66 (1986). The Court attempts to balance these continuing needs with society's changing fabric.

Quill submits that in this case the policies in favor of following *stare decisis* far outweigh those supporting departure. The principles of *Bellas Hess* were well reasoned in 1967 and provide a certain and workable framework relied upon by taxpayers and lower courts for over twenty-five years.<sup>27</sup> Because *Bellas Hess* involved a judicial interpretation of the commerce clause, Congress may correct through legislative action any misapplication it perceives.<sup>28</sup>

In fact, Congress is fully aware of the *Bellas Hess* decision and over the years it has refused to enact legislation urged by

<sup>27</sup> Pet. Br. at 27-33, App. 4 at 26a-29a; Pet. App. A76-A81; Amici Brief of National Association of Manufacturers, et al. at 14-19; Amici Brief of Arizona Mail Order Company, Inc., et al. at 7-11.

<sup>28</sup> The Advisory Commission on Intergovernmental Relations (ACIR), a non-partisan congressionally authorized body, examined the issue of state and local taxation of mail order sales. Recognizing the significance of several issues, especially that litigation has no possibility of addressing the various administrative problems concerning tax compliance, the ACIR recommended legislative rather than judicial revision of the *Bellas Hess* standard:

In the judgment of the majority of the Commission, only carefully crafted Congressional action can both negate the *National Bellas Hess* decision and achieve a delicate — but essential — balance.

ACIR Report, *State and Local Taxation of Out-of-State Mail Order Sales* (A-105) (April, 1986) at 18.

the states to alter the decision or its effect.<sup>29</sup> The fact that the *Bellas Hess* decision has been considered but not changed by Congress and that it has been consistently relied upon by taxpayers and numerous lower courts in determining taxable nexus raises "to their acme" the considerations in favor of applying *stare decisis* herein.<sup>30</sup> See *Payne v. Tennessee*, 111 S.Ct. 2597, 2610 (1991). Additionally, abandonment of *Bellas Hess* would likely result in state claims for billions of dollars of uncollected use taxes allegedly justified by anti-*Bellas Hess* statutes enacted as long ago as 1986.<sup>31</sup>

North Dakota advances no "compelling justification" for urging the Court to depart from the doctrine of *stare decisis*.<sup>32</sup> Its major premise is that "things have changed" and therefore the law must also change. In its enthusiasm to support the State's fisc, the North Dakota Supreme Court fails to see that the *Bellas Hess* decision is more analogous to a statutory standard and should only be altered by Congressional action. A lack of such action does not equate to "compelling justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984).

## VII. REAFFIRMATION OF *BELLAS HESS*

The most important practical effect of reaffirming the vitality of *Bellas Hess* will be in all likelihood to galvanize action in Congress to resolve inconsistencies in the application of use taxes nationwide in a manner which avoids undue burdens on interstate commerce while promoting fair and efficient state revenue systems. As the states have become more and more aggressive in asserting taxing power over out-of-state sellers, as

<sup>29</sup> See Pet. Br. at 34-36, 46-49.

<sup>30</sup> For a discussion of the problems that may be created for the mail order industry if *Bellas Hess* is not followed, see Amici Brief of Arizona Mail Order Company, Inc., et al. at 11-20. Adherence to established rules has a beneficial impact on the economy in general and departure from established precedent that affects investment decisions is harmful to a healthy and competitive economy. Amici Brief of National Association of Manufacturers, et al. at 10-12.

<sup>31</sup> See Amici Brief of Arizona Mail Order Company, Inc., et al. at 11-20, and App. 1b-3f

<sup>32</sup> Many states, including North Dakota, have alternative means for collecting use taxes from residents. See Pet. Br. at 46 and App. 3; Amicus Brief of Direct Marketing Association at 27-28; Amici Brief for New Hampshire, et al. at 23.

illustrated by the behavior of North Dakota's legislature and North Dakota's Supreme Court in this case, there has been less and less pressure for states to compromise their differences in designing Congressional legislation for uniform, simple and efficient measures for collection of use taxes by out-of-state sellers. That solutions can be reached under difficult political circumstances has recently been illustrated by actions of the European Community in establishing rules for cross-border mail order sales within Europe effective January 1, 1993, with respect to their sales taxes, which they call value-added taxes.

Overruling *Bellas Hess* will destroy the interstate marketplace as we now know it. The existing scope of freely flowing commerce among the states will be curtailed by reduced sales to consumers and, equally importantly, by reduced sales to business firms. One after the other the *amici* briefs in support of Petitioner illustrate:

1. the increased costs and compliance burdens on sellers which will lead to reduced interstate sales,<sup>33</sup>
2. the reduced availability of goods and supplies to consumers and businesses in rural areas and smaller cities,<sup>34</sup>
3. the likely reduction in the number of sellers and suppliers who through their huge number and wide variety offer customers a conveniently exercisable range of choice that probably exists nowhere else in the world,<sup>35</sup>
4. and a general reduction in marketing efficiency which will be reflected in increased prices and a narrower range of choice in selecting goods by size, shape, color, and design.<sup>36</sup>

<sup>33</sup> Amicus Brief of Direct Marketing Association at 14-23, 25-27; Amici Brief of Carrot Top Industries, Inc., et al. at 6, 8-13; Amicus Brief of Coalition for Small Direct Marketers at 12-21

<sup>34</sup> Amici Brief of American Council for the Blind, et al. at 11-12.

<sup>35</sup> Amicus Brief of Direct Marketing Association at 15; Amici Brief of Carrot Top Industries, Inc., et al. at 12; Amicus Brief of Coalition for Small Direct Marketers at 17-21; Amici Brief of American Council for the Blind, et al. at 12-13.

<sup>36</sup> Amicus Brief of Direct Marketing Association at 15-16; Amici Brief of American Council for the Blind, et al. at 12-13.

The national market is one of American's most prized possessions and is largely accounted for by this Court's continuing vigilance through its enforcement of the commerce clause. This Court can and does through its administration of this clause assure that the inevitably parochial interests of states acting alone are not allowed to thwart the national economic policy established by the Constitution's commerce clause. That critical power, coupled with Congressional power to regulate commerce among the states, permits the orderly, efficient, and fair evolution of state tax systems.

### CONCLUSION

For the reasons set forth in its briefs, Quill respectfully requests this Court to reverse the judgment below.

Respectfully submitted,

January 15, 1992.

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## **APPENDIX**

**SOFTWARE LICENSE**

QSL Software, including subsequent improvements, revisions, or updates (Software) is furnished by Quill as a service to Customer for the sole purpose of communication between Quill and its customers, under a non-exclusive, non-transferable license for use solely within the United States and Canada. Use outside the United States and Canada is prohibited. Software may be used on any of Customer's computers. To support authorized use or for back-up purposes only, software may be copied in whole or in part, provided that any and all copyright and other proprietary notices are reproduced. Customer may use Software only for communications between itself, Quill and others who have been provided the Software by Quill. Except as permitted in writing by Quill, Customer shall not provide or otherwise make available the Software or any part or copies thereof to any third party. Customer acknowledges that Quill owns all rights to the Software, including but not limited to, all patent, trademark, copyright and trade secret rights. Nothing herein shall transfer any rights in the Software to Customer. Customer may not copy, modify, decompile, disassemble, patch or otherwise alter or use the Software in whole or in part, except as expressly provided herein or permitted in writing by an officer of Quill.

Quill may terminate this license forthwith without prior notice and without cause. Upon termination Customer agrees to immediately return Software, and copies thereof and the user documentation to Quill. This license cannot be sublicensed and is not transferable or assignable by Customer. Customer may terminate this license at any time by returning all Software, any copies thereof, and user documentation to Quill. Termination shall not affect any of Customer's obligations hereunder and is without prejudice to the enforcement of any such obligations hereunder. All provisions protecting Quill's proprietary rights shall survive termination of this license.

This license agreement shall be governed by, subject to and construed in accordance with the laws of the State of Illinois. Any lawsuits arising from disputes relating to this license shall be determined exclusively in the courts of Illinois and Customer consents to the jurisdiction of the Illinois courts for this purpose. The prevailing party in any legal action brought to enforce this license shall be entitled to reasonable attorney's fees and costs from the other party.

SOFTWARE LICENSE NUMBER: 232527